

(3) a rate three percentage points above the prime rate as published in the *Star Tribune* and in effect on the first day of the month in which the capital debt is incurred; or

(4) 16 percent.

B. Variable or adjustable interest rates for allowable capital debts are allowed subject to the limits in item A. For each allowable capital debt with a variable or adjustable interest rate, the effective interest rate must be computed by dividing the interest expense including points, financing charges, and amortization of bond premiums or discounts for the reporting year by the average allowable capital debt. The average allowable capital debt shall be computed as in Section 9.030, item G, subitem (4).

C. The effective interest rate for capital debts incurred before January 1, 1984, is allowed in accordance with the laws and rules in effect at the time the capital debt was entered into provided the effective interest rate is not in excess of what the borrower would have had to pay in an arms-length transaction in the market in which the capital debt was incurred. For rate years beginning after September 30, 1987, the effective interest rate for debts incurred before January 1, 1984, is subject to the limit in item A, subitem (4), unless the refinancing of the capital debt is prohibited by the original terms of the agreement with the lender.

Section 9.030 Allowable interest expense. Allowable capital debt interest expense shall be determined in accordance with items A to J.

A. Except as in Section 9.010, item E, subitem (7), interest income earned on the required funded depreciation shall not be deducted from capital debt interest expense and working capital interest expense. Interest income earned on amounts deposited in a Development Cost Escrow Account required by the Minnesota Housing Finance Agency or other similar accounts and which is available during the reporting year to the provider or provider group shall be deducted from capital debt interest expense. Any other interest income shall not be deducted from capital debt interest expense. Except for interest income earned on the required funded depreciation, interest income available during the reporting year to the provider or provider group shall be deducted from the working capital interest expense.

B. All interest expense for capital debts entered into prior to January 1, 1984, shall be allowed in accordance with the laws and rules in effect at the time the capital debt was entered into provided the effective interest expense is not in excess of what the borrower would have had to pay in an arms-length transaction, except that for rate years beginning after September 30, 1987, the effective interest rate for debts incurred before January 1, 1984 is allowed subject to Section 9.020, item A, subitem (4).

C. A facility which has a restricted fund must use its restricted funds to purchase or replace capital assets to the extent of the cost of those capital assets before it borrows funds for the purchase or replacement of those capital assets. For purposes of this section, a restricted fund is a fund whose use is restricted by the donor, the nonprofit facility's board, or any other nonrelated organization, to the purchase or replacement of capital assets.

D. Construction period interest expense must be capitalized as a part of the cost of the physical plant. The period of construction extends to the earlier of either the first day a medical assistance recipient resides in the facility, or the date the facility is certified to receive medical assistance recipients, except that the period of construction cannot extend beyond the date on which the project is complete. A project is complete when a certificate of occupancy is issued or, if a certificate of occupancy is not required, when the project is available for use.

E. Interest expense for capital debts entered into after December 31, 1983, shall be allowed for the portion of the capital debt which together with all other outstanding capital debts does not exceed 100 percent of the historical capital cost of the facility's capital assets subject to the limitations in item H and Section 9.010, item C.

F. Interest expense for capital debts on capital assets acquired, leased, constructed, or established after December 31, 1983, shall be allowable only for the portion of the capital debt which does not exceed 80 percent of the historical capital cost of the capital asset including points, financing charges, and bond premiums or discounts subject to the limitations in item H and Section 9.010, item C.

(1) A newly constructed or newly established facility's interest expense limitation as provided in this item, on capital debt for capital assets acquired during the interim or settle-up period, will be increased by 2.5 percentage points for each full .25 percentage points that the facility's interest rate on its mortgage is below the maximum interest rate as established in Section 9.020, item A, subitem (2). For all following rate periods, the interest expense limitation on capital debt in item will apply to the facility's capital assets acquired, leased, or constructed after the interim or settle-up period. If a newly constructed or newly established facility is acquired by the state, the limitations of this item will not apply.

(2) A newly constructed or newly established ICF/MR that is developed and financed during the period beginning October 1, 1996 and ending June 30, 1997 must not be subject to the equity requirements in Section 9.050 or this item, provided that the provider's interest rate does not exceed the interest rate available through state agency tax exempt financing.

G. Changes in interest expense, except increases in interest expense due to refinancing of existing capital debts, or changes in ownership, shall be allowed in the calculation of the total payment rate for the rate year following the reporting year in which the cost was incurred. Changes in interest expense due to refinancing of existing capital debts, changes in ownership, or reorganization of provider entities, shall be subject to subitems (1) to (4).

(1) Increases in interest expense due to changes in ownership, reorganization of provider entity, or the refinancing of a capital debt, except for refinancing of a capital debt allowed under subitems (2) to (4), are not allowable costs.

(2) Increases in interest expense due to refinancing of a construction capital debt for a newly constructed facility are an allowable cost for the amount of the refinanced construction capital debt which does not exceed the limitation in item F. The interest rate on the refinanced construction capital debt shall be limited under Section 9.020.

(3) Increases in interest expense which result from refinancing of a capital debt with a balloon payment shall be allowed according to clauses (a) to (c).

(a) The interest rate on the refinanced debt shall be limited under Section 9.020, item A.

(b) The refinanced capital debt shall not exceed the balloon payment, except to the extent of refinancing costs such as points, origination fees, or title search.

(c) The term of the refinanced capital debt shall not exceed the term of the original debt computed as though the balloon payment did not exist. If the term of the original debt does not extend beyond the date of the final balloon payment, the term of refinanced capital debt shall not exceed 30 years including the term of the original capital debt.

(4) Increases in interest expense for a variable or adjustable rate capital debt are allowable if the effective interest rate does not exceed the limits in Section 9.020, item A, subitem (4). For each variable or adjustable rate capital debt, the effective interest rate shall be computed by dividing the interest expense including points, finance charges, and amortization of bond premiums and discounts, for the reporting year by the average allowable debt. The average allowable debt for each variable or adjustable rate capital debt shall be computed by dividing the sum of the allowable debt at the beginning and end of the reporting year by two. Any variable or adjustable rate capital debt which has zero balance at the beginning or end of the reporting year shall use a monthly average over the reporting year.

STATE: MINNESOTA

ATTACHMENT 4.19-D (ICF/MR)

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H. The cost of land purchased prior to January 1, 1984, shall be limited according to laws and rules effective on December 31, 1983. The cost of land purchased on or after January 1, 1984, shall be limited to \$3,000 per licensed bed. After May 1, 1990, the 1990 calendar year investment per bed limit for a facility's land must not exceed \$5,700 per bed for newly constructed or newly established facilities in Hennepin, Ramsey, Anoka, Washington, Dakota, Scott, Carver, Chisago, Isanti, Wright, Benton, Shelburne, Stearns, St. Louis, Clay, and Olmsted counties, and must not exceed \$3,000 per bed for newly constructed or newly established facilities in other counties.

I. Interest expense incurred as a result of a capital debt or working capital loan between related organizations shall not be an allowable cost, except as in item B.

J. Except as provided in item D, capital debt related financing charges including points, origination fees, and legal fees shall be amortized over the term of the capital debt.

Section 9.040 Computation of property related payment rate. The Department shall determine the property related payment rate according to items A to C.

A. The number of capacity days is determined by multiplying the number of licensed beds in the facility by the number of days in the facility's reporting year. For rate years beginning on or after October 1, 1988, a facility that has reduced its licensed bed capacity after January 1, 1988, may, for the purpose of computing the property-related payment rate under this section, establish its capacity days for each rate year following the licensure reduction based on the number of beds licensed on the previous August 1, provided that the Department is notified of the change by August 4. The notification must include a copy of the delicensure request that has been submitted to the Department of Health.

B. The Department shall compute the allowable property related costs by reviewing and adjusting the facility's property related costs incurred during the reporting year. The facility's property related per diem shall be determined by dividing its allowable property related costs by 96 percent of the capacity days. For facilities with 15 or fewer licensed beds, the Department shall use the lesser of 96 percent of licensed capacity days or resident days, except that in no case shall resident days be less than 85 percent of licensed capacity days.

C. The facility's property related payment rate shall be determined by adding the amount in item B, and the capital debt reduction allowance in Section 9.050, or the allowance in Section 9.070, item F.

Section 9.050 **Capital debt reduction allowance.** A provider whose facility is not leased or a facility which is leased from a related organization shall receive a capital debt reduction allowance. The amount of the capital debt reduction allowance and the reduction of capital debt required must be determined according to items A to G:

A. The total amount of the capital debt reduction allowance and the portion of that amount which must be applied to reduce the provider's capital debt shall be determined according to the following table:

<u>Percentage of Equity In Capital Assets Used By The Facility</u>	<u>Total Capital Debt Reduction Allowance Per Resident Day (In Dollars)</u>	<u>Amount Which Must Be Applied To Reduce Capital Debt (In Dollars)</u>
Less than 20.01	.50	.40
20.01 to 40.00	.50	-0-
40.01 to 60.00	.70	-0-
60.01 to 80.00	.90	-0-
80.01 to 100.00	1.10	-0-

B. Except as provided in Section 9.070, item F, the provider's percentage of equity in the facility shall be determined by dividing equity by total allowable historical capital cost of capital assets.

C. Each reporting year, the provider shall reduce the capital debt at the end of the reporting year by an amount equal to the portion of the capital debt reduction allowances paid during the reporting year which must be applied to reduce capital debt multiplied by the prorated resident days corresponding to each capital debt reduction allowance paid during the reporting year.

D. The amount of reduction of capital debt computed in item A must be in addition to the normal required principal payments on the capital debt to be reduced.

E. The amount of reduction of capital debt computed in item C must be applied first to reduce the principal on the allowable portion of any capital debt on which the provider is only required to pay interest expense. The remaining portion of the amount shall be applied to reduce other allowable capital debt starting with the capital debt which had the highest amount of interest expense during the reporting year.

F. If prepayment of a capital debt is prohibited by the funding source and the provider does not have any other capital debts, the portion of the capital debt reduction allowance which must be applied to reduce capital debt shall be applied first to the reduction of any working capital loans; the balance shall be deposited in the funded depreciation account. If prepayment of the capital debt results in the imposition of a prepayment penalty by the funding source, a portion of the capital debt reduction allowance which must be applied to reduce capital debt may be used to pay that penalty and the remainder may be used to reduce capital debt or the entire portion of the capital debt reduction allowance to be used to reduce capital debt may be deposited in the funded depreciation account.

G. For purposes of determining the provider's property related payment rate for the facility, only capital debt interest expense resulting from allowable capital debt reduced in accordance with items C to F shall be allowed.

H. Effective for the rate year beginning on or after October 1, 1993, if the facility's capital debt reduction allowance is greater than 50 cents per resident per day, that facility's capital debt reduction allowance in excess of 50 cents per resident per day shall be reduced by 25 per cent.

Section 9.060 **Energy conservation incentive.** The Department shall approve requests for exceptions to Section 4.080 and Section 9.030, item F for initiatives designed to reduce the energy usage of the facility. The requests must be accompanied by an energy audit prepared by a professional engineer or architect registered in Minnesota, or by an auditor certified to do energy audits. The cost of the energy audit is an allowable operating cost and must be classified in the plant operations and maintenance cost category. Energy conservation measures identified in the energy audit that:

A. have a payback period equal to or less than 36 months and a total cost not exceeding \$1 per resident day shall be exempt from Section 4.080 and Section 9.030, item F;
or

B. have a payback period greater than 36 months and a total cost not exceeding \$1 per resident day shall be exempt from Section 9.030, item F.

Section 9.070 **Reimbursement of lease or rental expense.** The provider or provider group's lease or rental costs shall be determined according to items A to J.

A. Lease or rental costs of depreciable equipment shall be allowed if:

- (1) the lease or rental agreement is arms-length; and
- (2) the lease or rental cost is equal to or less than the cost of purchasing that piece of depreciable equipment. For purposes of this subitem, the cost of purchasing the piece of depreciable equipment must be determined according to Sections 9.010 to 9.040 and item E; or
- (3) the arms-length lease or rental agreement for the piece of depreciable equipment covers a period of 60 days or less annually.

B. Leases or rental agreements shall be considered arms-length transactions unless the lease or rental agreement:

- (1) results from sale and lease-back arrangements;
- (2) results from a lease with option to buy at less than anticipated value;
- (3) is paid to a related organization; or
- (4) for other reasons is required to be capitalized in accordance with generally accepted accounting principles.

C. The costs of a lease or rental agreement for a facility's physical plant shall be subject to the following limitations:

- (1) Lease or rental costs which are not arms-length leases as defined in item B shall be disallowed.
- (2) Arms-length leases or rental costs shall be allowed subject to the limitations in item E.
- (3) Leases or rental costs incurred under agreements entered into on or before December 31, 1983, are allowable under rules and regulations in effect on December 31, 1983, subject to the conditions in item B and the limitations in item E.
- (4) Increases in lease or rental costs resulting from the renewal, renegotiation, or extension of a lease or rental agreement in subitem (3) are allowable to the extent that the

facility's property related payment rate does not exceed the average property related payment rate of all facilities in the state.

D. For nonarms-length lease or rental costs disallowed under item C, subitem (1) or (3), the provider shall receive in lieu of the lease or rental costs for the facility's physical plant the applicable depreciation, interest, and other reasonable property related costs incurred by the lessor, such as real estate taxes. Depreciation and interest shall be established in accordance with Sections 9.010 to 9.050, and shall be based on the lessor's historical capital cost of the capital assets and historical capital debt.

E. The present value of the lease or rental payments allowed in item A, subitem (2) and item C, subitems (2), (3), and (4) together with the historical capital cost of all other capital assets used by the facility shall not exceed the limitations in Section 9.010, item C; and Section 9.030, item H. The present value of the lease or rental payments must be calculated exclusive of real estate taxes and other costs assumed by the lessor. The interest rate used in calculating the present value of the lease or rental payments shall be the lessor's interest rate subject to the limits in Section 9.020. If the lessor's interest rate is not provided by the lessor, the Department shall use the interest rate limit established by the rule in effect on the date the lease or rental agreement became effective.

F. Providers with physical plant lease or rental costs disallowed under item C, subitem (1) if such a disallowance was the result of a less than arms-length agreement under item B, subitem (3) may receive the capital debt reduction allowance as in Section 9.050, except that for purposes of computing the percentage of equity in Section 9.050, the lessor and the lessee's historical capital costs of capital assets in the facility and the related historical capital debt must be used.

G. Facilities which lease capital assets from related organizations must fund depreciation in accordance with Section 9.010, item E.

H. In no case shall the allowed property related costs on the purchased capital asset exceed the annual cost allowed for the lease or rental agreement prior to the sale.

I. If a newly constructed or newly established facility is leased with an arms-length lease, the lease agreement will be subject to the following conditions:

(1) the term of the lease, including option periods, must not be less than 20 years;

(2) the maximum interest rate used in determining the present value of the lease must not exceed the lesser of the interest rate limitation in Section 9.020, item A, subitem (2), or 16 percent; and

(3) the residential value used in determining the net present value of the lease must be established using the provisions of Section 9.000.

J. All leases of the physical plant of an ICF/MR must contain a clause that requires the owner to give the Department notice of any requests or orders to vacate the premises 90 days before such vacation of the premises is to take place. In the case of unlawful detainer actions, the owner shall notify the Department within three days of notice of an unlawful detainer action being served upon the tenant. The only exception to this notice requirement is in the case of emergencies where immediate vacation of the premises is necessary to assure the safety and welfare of the residents. In such an emergency situation, the owner shall give the Department notice of the request to vacate at the time the owner of the property is aware that vacating the premises is necessary. This section applies to all leases entered into after the effective date of this section. Rentals set in leases entered into after that date that do not contain this clause are not allowable costs for purposes of medical assistance reimbursement.

SECTION 10.000 LIFE SAFETY CODE ADJUSTMENT.

Section 10.010 **Determination of adjustment.** Adjustments to the special operating cost payment rate for actions taken to comply with the Code of Federal Regulations, title 42, section 483.470, as amended through October 1, 1986, shall be determined under Section 10.000.

Section 10.020 **Conditions.** The Department shall allow an adjustment to a facility's special operating cost payment rate when the state fire marshal has issued a statement of deficiencies to the facility under the Code of Federal Regulations, title 42, section 442.508, as amended through October 1, 1986, if the criteria in items A to D are met.

A. The physical plant for which the statement of deficiencies was issued has 16 or fewer licensed beds.

B. The Department has determined that the most programmatically sound and cost effective means of correcting the deficiencies is to modify the physical plant or add depreciable equipment.

C. The cost of the physical plant modification or additional depreciable equipment cannot be covered by reallocating facility staff and costs including funds accumulated in the facility's funded depreciation account and other savings or investment accounts of the provider.

D. The provider has complied with the requirements in Sections 10.030 and 10.040.

Section 10.030 Request for life safety code adjustment. The provider shall submit to the Department a written request for a life safety code adjustment to the special operating cost payment rate. The request must include:

A. A copy of the state fire marshal's statement of deficiencies;

B. A copy of the facility's plan of correction approved by the state fire marshal; and

C. A description of the type of physical plant modifications or additional depreciable equipment required to meet the approved plan of correction including the estimated cost based on bids developed in accordance with Section 10.040.

Section 10.040 Bid requirements. Bids must be obtained from nonrelated organizations. Only the costs of items required to correct the deficiencies may be included in a bid. Each bid must include:

A. a detailed description of the physical plant modifications needed to correct the deficiencies;

B. the cost of any depreciable equipment needed to correct the deficiencies;

C. the cost of materials and labor; and

D. the name, address, and phone number of the bidder.

If the Department determines the bid submitted by the provider is excessive or includes items not required to correct the deficiencies, the Department may require a second bid and may recommend another organization that must supply the bid. This section shall not apply to a facility that has implemented a plan of correction before July 6, 1987.

Section 10.050 Evaluation of documents submitted. The Department shall evaluate the documents submitted under Section 10.030. If the Department determines that the plan of correction is not programmatically sound or cost effective, the Department may require the